100 Companies

	1973	1974	1975	1976	1977	1978	1979	1980
COMMON SHARE DATA — EQUALLY WEIGHTED INDEX								
Stock Price Index — Year-End	38.94	27.62	40.19	48.44	41.90	43.02	44.98	48.75
Reported Income per Share	2.98	3.20	3.14	4.04	4.47	5.54	5.99	5.19
Current Cost Income per Share	1.58	0.98	1.63	2.07	2.38	3.38	3.53	2.32
Economic Income per Share	4.39	8.55	6.12	6.52	6.42	9.89	9.06	9.87
Dividends per Share	1.15	1.28	1.35	1.54	1.77	1.95	2.19	2.23
Retained Current Cost Income per Share	0.44	−0.31	0.28	0.53	0.61	1.43	1.35	0.09
"LIFO" Earnings per Share (COGS Adjustment Only)	2.13	1.76	2.70	3.41	3.87	5.02	5.35	4.09
MARKET RATIOS								
P/E Reported Income (before Extraordinary Items)	13.1	8.6	12.8	12.0	9.4	7.8	7.5	9.4
P/E Current Cost Income (before Extraordinary Items)	24.6	28.2	24.7	23.5	17.6	12.7	12.7	21.0
P/E Economic Income (before Extraordinary Items)	8.9	3.2	6.6	7.4	6.5	4.3	5.0	4.9
P/E "LIFO" Income	18.3	15.7	14.9	14.2	10.8	8.6	8.4	11.9
Dividend Yield	2.9	4.7	3.4	3.2	4.2	4.5	4.9	4.6
ANALYTICAL RATIOS — % OF SALES								
Cost of Goods Sold Adjustment	1.12	2.14	0.57	0.54	0.54	0.59	0.54	0.78
Depreciation Adjustment	0.77	1.04	1.37	1.40	1.40	1.34	1.31	1.41
Total Current Cost Adjustment	1.88	3.18	1.94	1.93	1.94	1.92	1.85	2.19
Reported Historical Cost Net Income	5.87	4.90	4.66	5.45	5.43	5.61	5.15	4.19
"LIFO" Net Income	4.75	2.77	4.08	4.91	4.89	5.02	4.61	3.41
Current Cost Net Income	3.98	1.72	2.72	3.51	3.49	3.69	3.30	2.00
Economic Income	8.32	12.13	8.32	8.78	7.76	9.23	7.37	7.97
OTHER RATIOS								
Depreciation Rate	6.41	6.36	6.48	6.53	6.61	6.57	6.65	6.76
COGS Adjustment % Reported Income	19.06	43.58	12.28	9.83	10.03	10.43	10.46	18.65
Depreciation Adjustment % Reported Income	13.07	21.31	29.40	25.66	25.70	23.86	25.43	33.67
Current Cost Adjustment % Reported Income	32.13	64.89	41.68	35.49	35.73	34.29	35.89	52.32
TAX RATES								
Current Tax Rate — Reported	42.2	39.3	40.7	41.2	43.5	41.4	39.7	36.7
Deferred Tax Rate — Reported	2.9	5.4	3.9	3.6	1.8	3.5	1.8	4.0
Total Tax Rate — Reported	45.1	44.8	44.7	44.8	45.3	44.9	41.5	40.7
Current Tax Rate — Current Cost	51.5	61.8	53.2	51.6	54.7	51.6	50.8	54.0
Deferred Tax Rate — Current Cost	3.5	8.5	5.1	4.5	2.2	4.4	2.3	5.9
Total Tax Rate — Current Cost	55.1	70.3	58.3	56.1	56.9	56.0	53.1	59.9
Dividends % Reported Net Income	42.1	44.9	44.9	41.5	43.8	40.2	43.5	50.8
Dividends % Current Cost Net Income	62.1	127.8	77.0	64.3	68.1	61.2	67.8	106.6
Dividends % Cash Flow	25.4	25.6	24.7	24.9	26.8	24.6	25.7	25.9

BALANCE SHEET

100 Companies	1973	1974	1975	1976	1977	1978	1979	1980
ASSETS								
Cash and Equivalents	$ 19,177.3	$ 16,859.2	$ 23,209.4	$ 31,026.0	$ 33,119.1	$ 34,966.2	$ 30,739.4	$ 30,027.9
Accounts Receivable	39,712.2	45,006.9	46,183.5	50,814.4	58,766.4	69,370.8	78,092.0	85,560.9
Inventories — Reported	48,210.5	58,992.7	58,334.2	63,115.8	68,973.7	77,704.4	89,020.4	95,699.1
Current Cost Value of Inventories	52,765.0	68,763.6	69,621.9	76,671.5	84,834.0	96,929.7	114,467.0	126,109.9
Unrealized Holding Gain	4,554.5	9,770.9	11,287.7	13,555.7	15,860.2	19,225.2	25,446.6	30,410.8
Net Plant	83,970.0	94,363.2	102,713.5	111,329.5	122,604.5	139,858.6	159,757.1	183,898.6
Current Cost Value of Net Plant	111,572.3	138,846.8	156,348.5	173,516.3	191,807.8	221,947.3	245,884.1	286,096.3
Unrealized Holding Gain	27,602.3	44,483.5	53,635.0	62,186.8	69,203.2	82,088.6	86,127.0	102,197.7
Intangible Assets	3,259.6	3,811.4	3,542.8	3,531.9	3,500.0	4,465.9	5,378.8	5,335.9
Total Tangible Assets — as Reported	214,475.5	241,055.6	257,393.4	286,356.0	318,540.3	361,900.5	403,983.1	453,913.8
Total Tangible Assets — at Current Cost	246,632.4	295,309.9	322,316.0	362,099.4	403,603.8	463,214.3	515,556.7	586,522.4
LIABILITIES AND STOCKHOLDERS' EQUITY								
Current Liabilities excluding Short-term and Long-term Debt	47,555.9	54,367.3	57,421.7	67,040.3	77,497.5	92,218.0	102,185.1	115,671.4
Short-term Debt	10,901.1	14,749.1	10,713.9	10,613.2	11,857.6	12,217.5	17,250.2	22,087.7
Long-term Debt	31,570.0	36,607.0	42,040.6	43,512.3	48,494.4	53,771.9	57,581.7	67,332.9
Other Long-term Liabilities	5,423.3	5,739.2	5,793.2	6,869.9	9,043.6	10,537.4	13,353.9	14,005.9
Present Value of Financing Leases	1,511.5	1,891.5	2,135.7	2,424.0	1,103.5	2,560.5	2,777.2	2,768.9
Total Fixed Obligations	49,406.0	58,986.8	60,683.3	63,419.5	70,499.1	79,087.3	90,963.0	106,195.3
Deferred Taxes	5,076.5	5,951.9	7,011.5	8,213.8	8,870.3	10,857.8	12,602.5	16,228.6
Minority Interest	1,533.0	1,726.9	1,929.1	1,816.3	1,959.7	2,132.2	2,334.3	2,554.2
Preferred Stock — Liquidating value	4,564.6	4,802.2	4,625.9	4,727.0	5,175.8	5,796.5	6,586.7	6,975.2
Common Stock Equity — (Modified)	106,339.8	115,220.8	125,722.1	141,139.9	154,538.1	171,808.8	189,311.8	206,289.2
Revaluation Surplus	32,156.9	54,254.4	64,922.7	75,742.5	85,063.4	101,313.8	111,573.5	132,608.4
Total Stockholders' Equity — at Current Cost	143,061.3	174,277.4	195,270.7	221,609.5	244,777.3	278,919.2	307,472.1	345,872.9
Total Liabilities and Stockholders' Equity — at Current Cost	246,632.5	295,310.2	322,316.3	362,099.4	403,603.9	463,214.3	515,557.0	586,522.4
COMMON SHARE DATA — EQUALLY WEIGHTED INDEX								
Average Shares Outstanding	5,813.4	5,865.7	5,838.8	5,996.2	6,007.6	6,134.4	6,183.4	6,391.7
Book Value per Share — Modified — Reported	21.03	23.49	25.43	29.84	32.80	35.96	38.85	40.27
Unrealized Holding Gains per Share	6.48	11.63	13.62	16.70	18.34	21.62	23.70	26.18
Book Value per Share — at Current Cost	27.51	35.12	39.05	46.54	51.14	57.58	62.55	66.45
Unrealized Holding Gains % Reported Book Value	30.5	49.5	53.6	56.0	55.9	60.1	61.0	65.0

100 Companies

	1973	1974	1975	1976	1977	1978	1979	1980
MARKET RATIOS								
Market/Book Value Ratio — Reported — Year-end	1.85	1.18	1.58	1.62	1.28	1.20	1.16	1.21
Market/Book Value at Current Cost Value	1.42	0.79	1.03	1.04	0.82	0.75	0.72	0.73
Average Total Capital — Reported	$152,259.0	$169,660.0	$185,020.6	$200,158.9	$219,749.7	$243,452.8	$271,777.1	$303,160.5
Average Total Capital — at Current Cost	181,615.7	212,865.7	244,609.1	270,491.6	300,152.6	336,641.4	378,220.8	425,251.7
Average Stockholders' Equity — Reported	105,578.4	115,463.7	125,185.5	138,107.5	152,790.4	168,659.5	186,751.9	204,581.4
Average Stockholders' Equity — Current Cost	134,935.0	158,669.3	184,774.0	208,440.1	233,193.4	261,848.2	293,195.6	326,672.4
Total Earnings — % Average Total Capital — Reported	13.3	12.2	11.4	13.2	13.6	14.6	14.0	11.9
Current Cost Total Earnings % Average Total Capital at Current Cost	8.2	4.8	5.9	6.9	7.0	7.6	7.2	5.2
Net Income — % Average Stockholders' Equity — Reported	16.1	14.1	13.0	15.7	16.0	17.3	16.2	12.9
Current Cost Net Income % Average Stockholders' Equity	8.6	3.6	5.1	6.7	6.7	7.3	6.6	3.9
Reinvestment Rate % Average Stock Equity — Reported	9.3	7.8	7.2	9.2	9.0	10.3	9.1	6.3
Reinvestment Rate % Average Stock Equity — Current Cost	3.2	−1.0	1.2	2.4	2.1	2.8	2.1	−0.3
DEBT RATIOS — INTEREST COVERAGE								
Total fixed obligations % Total Capital — Reported	30.8	33.0	31.8	30.3	30.6	30.8	31.7	33.2
Total fixed obligations % Total Capital — Current Cost	25.7	25.3	23.7	22.3	22.4	22.1	22.8	23.5
Interest Coverage — Reported	10.2	7.5	6.9	9.0	8.8	8.9	7.4	5.1
Interest Coverage — Current Cost Basis	8.5	5.1	5.6	7.4	7.2	7.3	6.0	3.8
ASSET TURNOVER								
Sales to Inventory at Current Cost	5.49	4.83	5.03	5.19	5.29	5.36	5.12	5.00
Sales to Fixed Assets at Current Cost	2.60	2.39	2.24	2.29	2.34	2.34	2.38	2.20
Sales to Tangible Assets at Current Cost	1.18	1.12	1.09	1.10	1.11	1.12	1.14	1.07
Sales to Tangible Assets — Reported	1.35	1.38	1.36	1.39	1.41	1.44	1.45	1.38
SELECTED REAL RESULTS TO THE SHAREHOLDER (COMMON SHARE DATA EXPRESSED IN 1972 DOLLARS)								
Consumer Price Index — Urban 1972 Year-end = 100	108.8	122.1	130.6	136.9	146.2	159.4	180.6	203.0
% Change for Year	8.8	12.1	7.0	4.8	6.8	9.0	13.3	12.4
INCOME FLOWS								
Current Cost Income per Share	$1.46	$0.80	$1.25	$1.51	$1.63	$2.12	$1.96	$1.14
Dividends per Share	1.06	1.05	1.03	1.12	1.21	1.22	1.21	1.10
Retained Current Cost Income per Share	0.40	−0.25	0.22	0.38	0.42	0.90	0.75	0.04
Economic Income per Share	4.03	7.00	4.68	4.76	4.39	6.21	5.01	4.86
WEALTH EFFECTS								
Current Cost Book Value per Share	$25.28	$28.78	$29.90	$34.00	$34.98	$36.12	$34.64	$32.73
Market Price — Year-end	35.79	22.62	30.77	35.38	28.66	26.99	24.91	24.01

FUNDS STATEMENT

100 Companies	1973	1974	1975	1976	1977	1978	1979	1980
GROSS CASH FLOW								
Reported Net Income	$17,002.6	$16,269.3	$16,296.5	$21,685.2	$24,387.4	$29,146.0	$30,206.1	$26,441.7
Plus: Depreciation, etc.	10,339.1	11,356.9	12,314.9	13,303.4	14,781.3	16,476.3	19,141.5	21,857.8
Plus: Change in Deferred Tax Reserve	869.4	875.4	1,059.5	1,202.4	656.5	1,987.6	1,744.7	3,626.1
Gross Cash Flow from Operations	28,211.1	28,501.6	29,671.0	36,191.0	39,825.2	47,609.9	51,092.4	51,925.6
CAPITAL MAINTENANCE REQUIREMENTS DUE TO INFLATION								
Monetary Working Capital — Average	−6,711.6	−8,602.1	−10,299.3	−13,732.0	−17,478.5	−20,789.1	−23,470.2	−27,101.8
Price Change in COGS (PPI)	0.20	0.23	0.08	0.06	0.07	0.08	0.09	0.10
Required Change Monetary Working Capital	−1,342.3	−1,944.1	−844.5	−892.6	−1,223.5	−1,663.1	−2,065.4	−2,710.2
COGS Current Cost Increment	3,241.0	7,089.4	2,001.4	2,132.2	2,446.0	3,039.5	3,159.4	4,931.2
Fixed Asset Maintenance at Current Cost	12,560.9	14,824.4	17,106.6	18,867.7	21,049.7	23,430.6	26,822.9	30,760.1
Total Capital Maintenance Requirement	14,459.6	19,969.7	18,263.4	20,107.3	22,272.2	24,807.0	27,916.9	32,981.1
Discretionary Operating Cash Flow	13,751.5	8,531.9	11,407.5	16,083.7	17,553.1	22,802.9	23,175.4	18,944.5
Capital Maintenance % Cash Flow from Operations	51.3	70.1	61.6	55.6	55.9	52.1	54.6	63.5
DISCRETIONARY EXPENDITURES: DIVIDENDS AND INVESTMENT FOR GROWTH								
Dividends Paid	7,166.0	7,300.3	7,320.7	8,999.2	10,677.7	11,726.7	13,133.5	13,438.6
Monetary Working Capital Change Due to Volume	−921.8	427.2	−1,033.2	−4,095.1	−1,281.7	−2,453.0	819.4	−3,307.1
Inventory Change due to Volume	3,304.0	3,692.9	−2,660.0	2,649.5	3,411.9	5,691.1	8,156.5	1,747.5
Capital Expenditure Excess of Capital Maintenance	5,449.0	7,841.4	5,200.0	3,634.9	5,419.8	8,083.4	13,389.9	16,604.2
Net Cash Flow Before Financing	−1,245.5	−10,729.9	2,579.9	4,895.2	−674.6	−245.3	−12,323.9	−9,538.7
FINANCING								
Net Change in Total Fixed Obligations	5,450.6	9,580.8	1,696.6	2,736.2	7,079.6	8,588.1	11,875.8	15,232.3
Stock Financing — Net	642.0	418.9	1,492.0	1,272.4	64.1	842.1	1,181.1	2,094.9
Total Financing	6,092.6	9,999.7	3,188.6	4,008.6	7,143.7	9,430.2	13,056.9	17,327.2
Net Change Other Items and Cash	4,847.0	−730.2	5,768.5	8,903.8	6,469.1	9,184.9	733.0	7,788.5
RATIO: CAPITAL MAINTENANCE TO GROWTH								
Required Monetary Working at Capital Current Cost to Volume Change	1.46	−4.55	0.82	0.22	0.95	0.68	−2.52	0.82
COGS Current Cost Increment to Inventory Volume Change	0.98	1.92	−0.75	0.80	0.72	0.53	0.39	2.82
Fixed Assets Maintenance to Excess Capital Expenditures	2.31	1.89	3.29	5.19	3.88	2.90	2.00	1.85
Number of Companies on:								
ACCOUNTING METHODS								
Primarily LIFO and Accelerated Depreciation	4.0	11.0	12.0	12.0	12.0	11.0	11.0	11.0
Primarily LIFO and Straight Line Depreciation	17.0	38.0	39.0	39.0	39.0	40.0	43.0	44.0
Primarily FIFO and Accelerated Depreciation	20.0	12.0	12.0	12.0	13.0	13.0	13.0	12.0
Primarily FIFO and Straight Line Depreciation	59.0	39.0	37.0	37.0	36.0	36.0	33.0	31.0

Appendix B: Additional Readings

The literature of accounting, economics and general business has included an abundance of thoughtful writing in recent years on the subjects of inflation accounting and coping with an inflationary environment. The selections in the following listing are offered only as examples of what is available. An important criterion for listing in this appendix is that the suggested references are relatively easy to obtain. The information and explanations in these references will greatly enhance the reader's understanding of the matters discussed at The Conference Board's forum.

Baxter, John D., "Managers Turn to Real Dollar Data for Help," *Iron Age*, March 24, 1980.

Connor, Joseph E., "Elections Come, Elections Go: Inflation Persists," *Financial Executive*, March, 1981.

Loomis, Carol J., "How GE Manages Inflation," *Fortune*, May 4, 1981.

Lucas, Timothy S., *Understanding Inflation Accounting*, Financial Accounting Standards Board, Stamford, Connecticut, 1981.

Rappaport, Alfred, "Inflation and Corporate Dividends," *Financial Executive*, February, 1981.

Rappaport, Alfred, "Measuring Company Growth Capacity During Inflation," *Harvard Business Review*, January-February 1979.

Revsine, Lawrence, "Let's Stop Eating Our Seed Corn," *Harvard Business Review*, January-February 1981.

Ronen, Joshua and George H. Sorter, "Providing Relevant Financial Statement Information in a Period of Changing Prices," Robert Lindsay, ed., *The Nation's Capital Needs: Three Studies.*" Washington, D.C.: Committee for Economic Development, 1981.

Walsh, Francis J., Jr., "Recognizing Inflation in Accounting," The Conference Board, Report No. 783, 1980.

Webster, Frederick E., Jr.; James A. Largay, III; Clyde P. Stickney, "The Impact of Inflation on Marketing Decisions," *Journal of Marketing*, Fall, 1980.

"Which Inflation Rate Should Business Use?" *Business Week*, April 7, 1980, p. 94.

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by John Hein

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IN JULY, 1981, a panel of economists, planners and analysts in U.S. private industry were asked by The Conference Board for their assessment of economic conditions abroad in 1982. Specifically, the panel members were asked for "projections of economic activity for countries that are important in your company's foreign operations or on which you normally gather information. You may include projections of gross national product, industrial production, inflation rates, and so forth, as well as a brief discussion of the assumptions on which these forecasts are based."

This report is based on the replies received from panelists in 15 major business organizations. Eleven of these are among the 250 largest U.S. industrial corporations as listed by *Fortune;* three are in the financial and transportation sectors. Most of the material submitted was prepared between early July and early September.

The Conference Board believes that this kind of survey—of which this is the sixth—is valuable, since these corporate assessments are important in determining the level and mix of capital expenditures, marketing programs, and production schedules for the companies' foreign affiliates. In preparing their projections companies obviously do not generate their own basic data, but derive those from a wide variety of sources—government agencies, banks, econometric services, and so forth—both in the United States and abroad. That information is then adapted in the light of a company's own experience in order to erect a suitable framework for overseas planning.

This theme of utilizing the projections as background for operating purposes recurs constantly in the material submitted. As one panelist remarked: "The information shown has been extracted from a more comprehensive outlook, prepared by a multidisciplinary team and developed twice a year as input to our strategic planning and budgeting cycles." Others similarly noted that the material was prepared "in connection with review of strategic plans for international operations," or was put together "three times per year to coincide with the three stages of our corporate planning process."

Indeed, it is worth stressing that the data developed by the panelists for internal corporate use are not predictions, but merely estimates of the ranges within which certain parameters might fall in the near term. Moreover, as one participant pointed out, these estimates "do not depict extreme developments. They are *mean* results of the possible paths economies might follow in the absence of such major disruptions as cutoffs in oil supplies, world crop disasters, and so on."

Thus, these corporate forecasts aim to incorporate all relevant known information about the near future, using methods that range from the highly technical to pure hunch. Moreover, to the extent that one can "assume away" both major external shocks and major policy shifts, the performance of past estimates can be used to narrow the range of uncertainty about the future. And while it is often difficult to know why a particular forecast turned out to be wrong, that does not mean, however, that the accuracy of the historical record can necessarily be judged by the size of the errors alone (see box).

On Forecasting Errors

Forecasting ability cannot be measured *absolutely* by the magnitude of errors because the degree of uncertainty varies over time. "Small" errors, relative to historical experience, are a poor measure of forecasting skill in a period when all other forecasters are even closer to the mark. "Large" errors are not a sign of incompetence in periods when all other forecasts are even worse. Ideally, forecasting ability must be judged *comparatively,* not absolutely. A "good" forecast is one that is more accurate than everyone else's regardless of the size of the error. A forecast is "poor," no matter how small the error, if other forecasts produced smaller errors.

Stephen K. McNees, "The Optimists and the Pessimists: Can We Tell Whose Forecast Will Be Better?" Federal Reserve Bank of Boston, *New England Economic Review,* May/June, 1981.

GENERAL OVERVIEW

In its midyear economic review, released last July, the Organization for Economic Cooperation and Development (OECD), which encompasses the 24 major industrial countries, noted: "The immediate outlook is complex and difficult for most countries, with a protracted transition from recession to renewed growth, accompanied by inflation and unemployment which are are too high, yet hard to reduce." The Conference Board's *International Economic Scoreboard* commented in October that, to judge from the leading economic indicators for July and August, recovery abroad "may have stalled, but not necessarily ended" (see Chart 1).

The U.S. Commerce Department noted similarly that foreign industrial production had declined in the second quarter of this year and stood only 0.4 percent above the low reached during the 1980 recession, "reflecting slow and hesitant progress." This markedly weak recovery in output abroad contrasted sharply with the experience in 1974-1975, when foreign production had recorded a steady 19-month upturn from its low in mid-1975.

The panel shared the generally cautious view on where the major economies were currently at, with only slight differences as to the direction they were going to take next year. However, there were some marked differences of opinion as to the underlying causes for the "complex and difficult" outlook. Most panelists were at pains to stress that recovery abroad—whenever it came and however delayed it might be—would be relatively "unsynchronized" and slow.

Thus, one respondent wrote: "Economies in the industrialized world are not snapping back from recession or stagnation. But recoveries are on their way." Another commented: "The recession of 1980-1981 has about run its course, and the world economies now stand poised for a slow but sustained recovery." Only one lonely voice felt that, with economic activity continuing quite weak, recovery remained "elusive," especially among the European economies.

The panelists generally agreed that the current situation reflected to a large degree the authorities' determination to avoid the mistakes of the early 1970's, when most countries had employed expansionary measures to offset the deflationary effects of the first "oil shock." This time around policymakers everywhere seemed determined to maintain fiscal and monetary austerity long enough to squeeze inflation out of their economies once and for all. One panelist detected three distinct factors that were affecting the current outlook and were making it particularly important to be prepared "for more than the ordinary amount of mid-course correction" of country projections:

> "The broadest and most elusive of these is the redefinition of the national goals that is going on in much of the world. Examples abound. Here in the United States, there is a new direction in fiscal and monetary policy and in the stance on defense. In Canada, there are regional struggles over energy policy and the relative powers of the federal and provincial governments. Britain is trying to reduce the government's role in the economy. Similar fundamental changes are afoot elsewhere, sometimes in one direction, sometimes in another. The political currents thus set loose will, to a major extent, determine how we deal with the problems that confront us.
>
> "The other two factors are more tangible, although just as unpredictable. Last year there was a consensus, albeit an incorrect one as far as this year is concerned, that real oil prices would continue to increase. Now there is general confusion and disagreement on future oil prices. But it is clear that oil prices have a direct impact, in one way or another, on inflation rates and balance of payments.
>
> "The last fact, which has been particularly disturbing to the operations of multinational companies, is instability in interest and exchange rates. Over the past year, the prime rate in the United States has ranged from a high of 20½ percent to a low of 10½ percent. Exchange rates have shown similar dramatic shifts."

Panelists were not unanimous, however, on the role played by the United States and by U.S. economic policies in the current plight of the industrial world. Remarked one respondent: "The near-term outlook for the major foreign economies, particularly Western Europe, depends to a large extent on U.S. monetary policy over the next few quarters. As long as U.S. policy remains restrictive, it is unlikely that Western Europe will be able to turn to more expansionary policies, for a unilateral decision to do so would lead to a further decline in their currencies against the dollar."

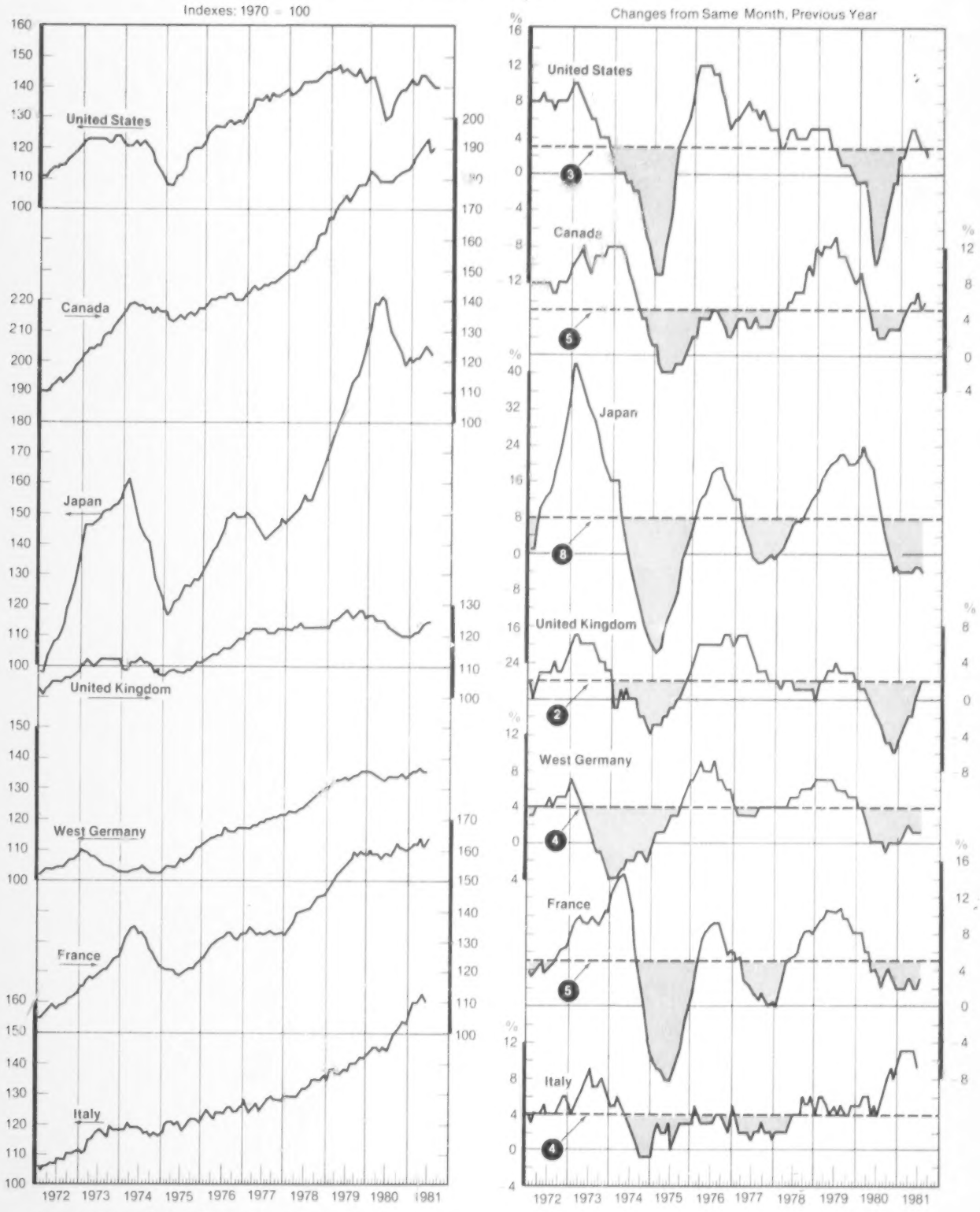
Another panelist came out with a diametrically opposed view: "In our opinion, the economic and social strains afflicting Europe and Japan have nothing to do with U.S. behavior. We believe that the immediate causes are the inordinate rises in oil prices, the high debt-to-GNP ratios prevailing in Europe, and geopolitical considerations." Elaborating on the second point, he noted that, while the U.S. budget deficit amounted to approximately 1 percent of gross domestic product, the equivalent burden was substantially higher abroad, and that it was this fact that prevented European policymakers from applying greater fiscal stimulus. (The relevant ratios are given below.)

Net Government Borrowing as Percent of Gross Domestic Product, 1981

Belgium	9.7%	Ireland	11.7%
Denmark	5.7	Italy	8.4
France	1.8	Netherlands	3.2
Germany	3.8	United Kingdom	4.3

Chart 1

Leading Business Cycle Indexes



Source: *International Economic Scoreboard*, The Conference Board, October, 1981.

On the third point, he commented: "The dynamics of Russian imperialism, both directly and through a global network of mercenaries and surrogates are realities which businesses no less than governments abroad understand perfectly well, and which are having significant impact on investment plans."

Another respondent also noted that: "The growing budgetary deficit is not a unique U.S. phenomenon. Rather, it is a common malady being suffered by all the major industrial economies where governments have assumed increasing economic and social responsibilities." He added that government expenditures for the seven major industrial countries combined rose from 32 percent of gross national product in 1970 to 42 percent last year. Thus, in the current policy mix, fiscal policies virtually everywhere are unsupportive of monetary policies, and "gradualism and caution will only defer the judgment day."

MAJOR INDUSTRIAL COUNTRIES

The panel's assessment of the outlook for the major industrial countries abroad generally pointed in the same direction, but there were, of course, diverse and often widely scattered views as to the actual numbers for individual countries. Some of these projections by various participants are shown in Chart 2, in order to illustrate the range of "most likely" outcomes foreseen by panel members. As counterpoint to these projections the table below gives the latest official forecasts by the OECD. (Projections for the smaller industrial countries and several developing countries are given in the appendix.)

The Official Forecast of Growth and Inflation

	Percentage changes at annual rates				
	From previous year		*From previous half-year*		
Growth of Real GNP	*1981*	*1982*	*1981* *II*	*1982* *I*	*II*
United States	2.5	1.0	0.5	0.5	2.5
Canada	2.5	2.5	1.75	3.0	2.75
Japan	3.5	4.0	3.0	4.0	5.0
France	—0.5	1.75	0.25	2.0	2.5
Germany	—1.5	2.0	—1.5	2.75	3.75
Italy	—0.75	1.75	0.5	2.0	2.75
United Kingdom	—1.5	0.25	—1.0	0.5	1.0
Total of seven countries	1.25	1.75	0.5	1.75	3.0
Other OECD countries	1.25	3.0	2.0	3.0	3.5
Total OECD	1.25	2.0	1.0	2.0	3.0
GNP Deflators					
United States	9.0	7.75	7.0	8.25	7.25
Canada	10.5	11.0	10.75	11.0	10.75
Japan	5.0	4.75	5.5	4.5	4.5
France	11.75	11.5	11.5	11.75	11.0
Germany	4.25	3.5	3.5	3.5	3.25
Italy	19.0	17.5	18.5	17.5	16.0
United Kingdom	13.5	10.0	12.5	9.25	8.5
Total of seven countries	9.0	8.0	8.0	8.25	7.5
Other OECD countries	13.25	11.75	12.75	11.75	11.0
Total OECD	9.75	8.75	9.0	8.75	8.25

Source: Organization for Economic Cooperation and Development, *Economic Outlook*, July, 1981.

The early 1980's will not be exactly easy for **Canada**, according to the latest annual review by that country's Economic Council. The Council cited pervasive problems of inflation, government and trade deficits, unemployment and sluggish growth as issues that were likely to persist in the near term. But it also warned that unless the questions of domestic oil pricing policy, delays in energy investment, acceleration of inflationary pressures, and the federal government deficit were dealt with, they could affect the economy's performance over the medium term as well. The Council was particularly concerned that, so long as uncertainty about energy pricing and the sharing of oil revenues persisted, large-scale investments in energy and ancillary industries would be held up.

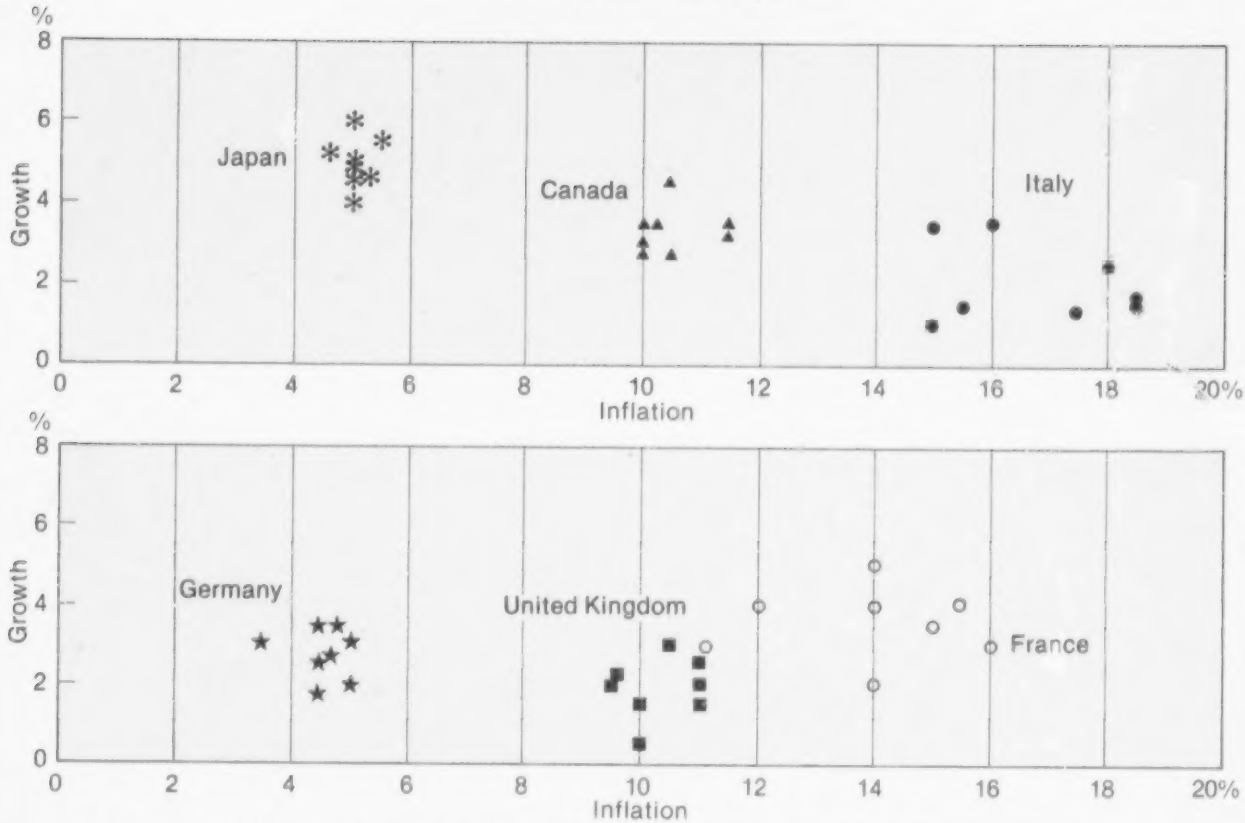
Moreover, as a private Canadian research organization pointed out recently, trends in both Canadian economic policy and activity have tended to be largely determined by events in the United States. There were, in fact, few, if any, buffers that could protect Canada from the spillover of U.S. policy or from the depressed state of U.S. business activity. "Canada's vulnerability is a fact of life and can be reduced over time only by policies that reduce the deficit on trade in goods and services and improve the adequacy of domestic energy supply."

While the panel members were fully cognizant of these and related issues, their attention naturally was focused on the year ahead. An amicable and mutually acceptable solution to the problem of energy pricing was the keynote in most replies. Renewed growth of the country's economy—generally estimated at between 2.7 and 3.5 percent for 1982 by the majority of panel members—was predicated on prospects "for some compromise solution on energy policies between Ottawa and Alberta that will improve the environment for energy-related investment." Another panelist similarly commented that "interregional friction over energy and natural resource policies, if unresolved, could lead to sharp cuts and delays in the energy investments assumed in the outlook."

Panelists also stressed the traditionally close links between the U.S. and the Canadian economies. Not only was activity in Canada dependent to a considerable extent on the performance of the United States, but the decline of the Canadian relative to the U.S. dollar has raised the cost of products imported from the United States. In addition, domestic investment funds have left the country for the even higher rates of return available in the United States, while capital inflows for business ventures have

Chart 2

Growth and Inflation in Six Countries: Forecasts for 1982



Observations represent forecasts for growth and inflation rates in 1982 for a given country as submitted by individual panelists.

fallen off. The toughening of the attitude of the country's Foreign Investment Review Agency with respect to the entry of foreign interests has further discouraged such inflows. (In late September, the proposed strengthening of the agency's powers was shelved by the government.)

Nevertheless, one panelist believes that 1982 "has the potential to be a year of improvement, both in terms of real growth and on the inflation front." In fact, the panel was nearly unanimous on the price picture, predicting an inflation rate of 10 to 10.5 percent, as against 12 to 13 percent this year. To some extent, this improvement reflects dissipation throughout the economy of the initial effects of the new energy policy. Moreover, as the economies of Canada's major trading partners are expected to grow somewhat faster next year, the prospects are for modest gains in exports.

Japan, the monthly letter of a major New York bank pointed out recently, "is confident but hardly relaxed. It combines a public stance of sturdy self-assurance with semipublic twinges of self-doubt." This Janus-like attitude emerges in various appraisals of Japan's near-term economic prospects. Thus, Keidanren, the Japanese federation of industry, earlier this year saw the country's economy as "experiencing a slowdown because it is still in the process of absorbing the shock of the second oil crisis." Moreover, the federation suggests, current economic trends indicate "that it will be no easy task for Japan to achieve even modest growth in the rest of the decade. Indeed, the Japanese economy could veer off in the wrong direction if its underlying strength or 'resilience' were to be overestimated on the basis of its outward performance of recent years."

Among the potentially adverse factors cited by Keidanren are uncertainties in the energy outlook; fairly strong exports causing "trade friction if Japan fails to act properly at a time when the economies of its trading partners remain in distress"; and little optimism over inflation prospects if higher prices for energy and raw materials keep adding to costs.

Taking a somewhat limited and shorter run view, The Conference Board's panel foresees a generally growing

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pace of economic activity for Japan in the second half of 1981 and well into 1982. Thus, by late this year the Japanese economy is expected to have fully recovered from its mild downturn, and by the end of 1981 inflation is expected to have slowed down considerably. In addition, the yen is seen as strengthening next year because of slowing inflation and rising productivity. Indeed, just as in 1981, Japan's growth rate for next year once more is expected to be the highest for the industrial countries.

But, beyond this general picture, most respondents focused on two key issues likely to bedevil the Japanese authorities for some time to come--exports and defense. One sketched the background this way: "Prime Minister Suzuki is having some rough sailing. There are two key foreign issues. One is Washington's determination that Japan spend more on defense. The other is protectionism." Writes another: "The United States and the EEC are likely to intensify demands for easier access to Japanese markets and greater voluntary control of Japanese exports. On defense, the United States will continue to push for a bigger effort on the part of the Japanese."

Indeed, with Japan's trade balance and current account improving, as the yen remains temporarily undervalued against the dollar and most other major currencies, the continued penetration of Japanese exports into major overseas markets is arousing concern all around. In the wake of the agreed-on cutback of autombile sales to the United States—and similar cuts to the European Community—it is believed that these (and future) reductions in overseas auto sales may well be made up by a new export drive centered on goods with high technological content, such as microcomputers, word processors, videotape recorders, and industrial robots.

It remains to be seen how this export drive will fare once the yen begins to strengthen against the dollar. That may happen once the economy begins to turn around—and may depend on factors other than simply interest-rate levels in dollar markets.

Discussing the outlook for **France** in 1981, this survey noted a year ago that Prime Minister Raymond Barre, once billed as "France's best economist," had completed four years in office. During that time, he had presided over an extraordinary change in French economic life: He had slowly begun "to take the government out of business." Alas, as the Romans had it, *tempora mutantur,* and the wheel now seems to have swung full circle.

The election of Francois Mitterand as president last May, and the return of the Socialists to power after 23 years, marked a political revolution of the first magnitude. But, as *The Banker* remarked shortly after the election, "whether France has also opted for economic revolution remains less certain." Nevertheless, major changes have been announced at three separate levels. First, proposals are being drawn up providing for substantial devolution of power from Paris to local governments, giving regions and municipalities the right to decide major issues locally (spending, planning, etc.). The second shift involves an expansion of the public sector through nationalization of major enterprises. The third component aims at a vast redistribution of income in favor of the lower income sectors.

Mr. Mitterand was elected on an economic platform that appears to have something for everybody—ranging from rises of 50 percent in family allowances and state pensions, through over 200,000 additional public-sector jobs, to a reduction from 40 to 35 hours in the workweek. Further promised benefits include retirement at 60, a fifth week of vacations, a 23 percent rise in the minimum wage, and a 50 percent increase in housing subsidies to tenants. The weakness of such a spending binge is, of course, that it would create an enormous budget deficit and rapid inflation. Also on the drawing boards are proposals for windfall profit taxes for the banking and oil industries, a surtax on higher level incomes, and higher sales (value-added) taxes on some luxury items. In addition, the government committed itself to the biggest nationalization program of any Western European country in 20 years—covering five large industrial companies and the 36 biggest banks.

This gigantic program is being prescribed for the French economy at a time when it already is facing a number of problems—unemployment standing at 1.5 million, and perhaps heading for 2 million by year-end; a rise in consumer prices of 1.8 percent in July, pointing to an 18 percent inflation rate for the year as a whole; a weakened franc; and a growing trade deficit.

The uncertainties and complexities generated by this scenario are apparent in the views of the panel. "The new programs are going to be expensive; monetary policy has been complicated by the need to defend the franc; inflation remains a problem; the corporate sector is hurting; we do not believe that France has entered a golden age." Similar observations dot the panel's replies. True, despite such misgivings and full recognition of the problems facing the country, all panelists agree that France still will outperform the other European economies next year. Although the current economic recovery is seen as being "based on a weak foundation," and "it is too early to predict the economic consequences of the election very precisely," France is "widely expected to lead the rest of Europe."

As to the government's ambitious program, one panel member alludes to speculation as to the extent of Mitterand's ability to put all of his proposed policies in place. "Mitterand will have to walk a tightrope in balancing overly stimulative and inflationary social and economic programs desired by the people with overly restrictive and deflationary monetary policies used to